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Insurance Regulation: Issues, Background, and Legislation in the 112th Congress

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Summary

The individual states have been acknowledged as the primary regulators of insurance since 1868. Following the 1945 McCarran-Ferguson Act, this system has operated with the explicit blessing of Congress, but has also been subject to periodic scrutiny and suggestions that the time may have come for Congress to reclaim the regulatory authority that it granted to the states. In the late 1980s and early 1990s, congressional scrutiny was largely driven by the increasing complexities of the insurance business and concern over whether the states were up to the task of ensuring consumer protections, particularly insurer solvency.

Immediately prior to the recent financial crisis, congressional attention to insurance regulation focused on the inefficiencies in the state regulatory system. A major catalyst was the aftermath of the Gramm-Leach-Bliley Act of 1999 (GLBA), which overhauled the regulatory structure for banks and securities firms, but left the insurance sector largely untouched. Many larger insurers, and their trade associations, had previously defended state regulation but considered themselves at a competitive disadvantage in the post-GLBA regulatory structure. Some advocated for an optional federal charter similar to that available to banks. Various pieces of insurance regulatory reform legislation have been introduced, including bills establishing a broad federal charter for insurance as well as narrower, more targeted bills.

The states, particularly working through the National Association of Insurance Commissioners (NAIC), were not idle following congressional attention. They reacted quickly to GLBA requirements that related to insurance agent licensing and have since embarked on a wider-ranging project to modernize insurance regulation. This has included both regulatory aspects, such as streamlining the process for rate and form filing, and more basic legal aspects, such as the creation of an interstate compact to provide uniformity across states for some life insurance products. Because enactment by the state legislature is necessary before the legal changes suggested by the NAIC can take effect in that state, the process typically does not move rapidly.

The recent financial crisis refocused the debate surrounding insurance regulatory reform. Unlike in many financial crises in the past, insurers played a large role in this crisis. In particular, the failure of the large insurer American International Group (AIG) spotlighted sources of risk that had gone unrecognized. The need for a risk regulator for the entire financial system was a common thread in many of the recent financial regulatory reform proposals. The Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203), enacted following the crisis, gave enhanced systemic risk regulatory authority to the Federal Reserve and to a new Financial Services Oversight Council (FSOC), including some oversight authority over insurers. The Dodd-Frank Act also included measures affecting the states' oversight of surplus lines insurance and reinsurance and the creation of a new Federal Insurance Office (FIO) within the Treasury Department.

The 112th Congress faces both relatively new issues arising from the Dodd-Frank Act (addressed in H.R. 3559 and H.R. 6423) and issues that predate the financial crisis, such as the licensing of insurance agents and brokers (addressed in H.R. 1112) and the expansion of the federal Liability Risk Retention Act (addressed in H.R. 2126). In addition, various international issues may be of concern to Congress, such as the European Union's Solvency II project to overhaul the European insurance regulatory system.

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Introduction and Background

Insurance companies constitute a major segment of the U.S. financial services industry. The industry is often separated into two parts: life and health insurance companies, which also often offer annuity products; and property and casualty insurance companies, which include most other lines of insurance, such as homeowners insurance, automobile insurance, and various commercial lines of insurance purchased by businesses. Premiums for life/health companies in 2011 totaled $581.4 billion whereas premiums for property/casualty insurance companies totaled $436.0 billion.[1] Assets held by the insurance industry totaled approximately $7.5 trillion according to the National Association of Insurance Commissioners (NAIC).

Different lines of insurance present very different characteristics and risks. Life insurance typically is a longer-term proposition with contracts stretching into decades and insurance risks that are relatively well defined in actuarial tables. Property/casualty insurance typically is a shorter-term proposition with six-month or one-year contracts and greater exposure to catastrophic risks. Health insurance has evolved in a very different direction, with many insurance companies heavily involved with healthcare delivery, including negotiating contracts with physicians and hospitals and a regulatory system much more influenced by the federal government through Medicare, Medicaid, the Employee Retirement Income Security Act of 1974 (ERISA),[2] and the Patient Protection and Affordable Care Act (ACA).[3] This report addresses primarily life insurance and property/casualty insurance.[4]

Insurance companies, unlike banks and securities firms, have been chartered and regulated solely by the states for the past 150 years. One important reason for this is an 1868 U.S. Supreme Court decision.[5] In *Paul v. Virginia*, the Court held that the issuance of an insurance policy was not a transaction occurring in interstate commerce and thus not subject to regulation by the federal government under the Commerce Clause of the U.S. Constitution. Courts followed that precedent for the next 75 years. In a 1944 decision, *U.S. v. South-Eastern Underwriters Association*, the Court found that the federal antitrust laws were applicable to an insurance association's *interstate* activities in restraint of trade.[6] Although the 1944 Court did not specifically overrule its prior holding in *Paul*, *South-Eastern Underwriters* created significant apprehension about the continued viability of state insurance regulation and taxation of insurance premiums. By 1944, the state insurance regulatory structure was well established, and a joint effort by state regulators and insurance industry leaders to legislatively overturn the *South-Eastern Underwriters* decision led to the passage of the McCarran-Ferguson Act of 1945.[7] The act's primary purpose was to

[1] Premium amounts used are net premiums written from AM Best, *202 Statistical Study: U.S. Property/Casualty – 2011 Financial Results*, March 26, 2012, and AM Best, *2012 Statistical Study: U.S. Life/Health – 2011 Financial Results*, March 28, 2012.

[2] P.L. 93-406, 88 Stat. 829.

[3] P.L. 111-148, 124 Stat. 119.

[4] For more information on health insurance, see CRS Report RL32237, *Health Insurance: A Primer*, by Bernadette Fernandez.

[5] *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868).

[6] *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944).

[7] 15 U.S.C. §1011 *et seq.*

preserve the states' authority to regulate and tax insurance.[8] The act also granted a federal antitrust exemption to the insurance industry for "the business of insurance."[9]

After 1945, the jurisdictional stewardship entrusted to the states under McCarran-Ferguson was reviewed by Congress on various occasions. Some narrow exceptions to the 50-state structure of insurance regulation have been enacted, such as one for some types of liability insurance in the Liability Risk Retention Act (LRRA) created by Congress in 1981 and amended in 1986.[10] In general, however, when proposals were made in the past[11] to transfer insurance regulatory authority to the federal government, they were successfully opposed by the states as well as by a united insurance industry. Such proposals for increased federal involvement usually spurred a series of regulatory reform efforts at the individual state level and by state groups such as the National Association of Insurance Commissioners and the National Conference of Insurance Legislators (NCOIL). Such efforts were directed at correcting perceived deficiencies in state regulation and forestalling federal involvement. They were generally accompanied by pledges from state regulators to work for more uniformity and efficiency in the state regulatory process.

A major effort to transfer insurance regulatory authority to the federal government began in the mid-1980s and was spurred by the insolvencies of several large insurance companies. Former House Energy and Commerce Committee Chairman John Dingell, whose committee had jurisdiction over insurance at the time, questioned whether state regulation was up to the task of overseeing such a large and diversified industry. He chaired several hearings on the state regulatory structure and also proposed legislation that would have created a federal insurance regulatory agency modeled on the Securities and Exchange Commission (SEC). State insurance regulators and the insurance industry opposed this approach and worked together to implement a series of reforms at the state level and at the NAIC. Among the reforms implemented was a new state accreditation program setting baseline standards for state solvency regulation. Under the accreditation standards, to obtain and retain its accreditation, each state must have adequate statutory and administrative authority to regulate an insurer's corporate and financial affairs and the necessary resources to carry out that authority. In spite of these changes, however, another breach in the state regulatory system occurred in the late 1990s. Martin Frankel, an individual who had previously been barred from securities dealing by the SEC, slipped through the oversight of several states' insurance regulators and diverted more than $200 million in premiums and assets from a number of small life insurance companies into overseas accounts.[12] Despite the embarrassment to state regulation, this did not bring long-term change to federal policy.

[8] Richard Cordero, *Exemption or Immunity from Federal Antitrust Liability Under McCarran-Ferguson (15 U.S.C. 1011-1013) and State Action and Noer-Pennington Doctrines for Business of Insurance and Persons Engaged in It,* 116 ALR Fed 163, 194 (1993).

[9] 15 U.S.C. §1012(b). The Supreme Court has made clear that the business of insurance does not include all business of insurers in *Group Health and Life Insurance, Co. v. Royal Drug, Co.,* 440 U.S. 205, 279 (1979). For further explanation of this distinction, see CRS Report RL33683, *Courts Narrow McCarran-Ferguson Antitrust Exemption for "Business of Insurance": Viability of "State Action" Doctrine as an Alternative*, by Janice E. Rubin.

[10] 15 U.S.C. §3901 *et seq*. See CRS Report RL32176, *The Liability Risk Retention Act: Background, Issues, and Current Legislation*, by Baird Webel.

[11] Most such proposals prior to the 1990s focused on relatively narrow amendments to McCarran-Ferguson rather than large scale replacement of the state regulatory system.

[12] See, for example, "17-Year Sentence Affirmed for Investor Who Looted Insurers," *New York Times*, March 24, 2006, available at http://www.nytimes.com/2006/03/24frankel..html?ref=martinfrankel.

Another state reform largely implemented in the late 1980s and early 1990s was the introduction of state insurance guaranty funds.[13] These funds, somewhat analogous in function to the Federal Deposit Insurance Corporation (FDIC) for banks, provide protection for insurance consumers who hold policies from failed insurance companies. If an insurance company is judged by a state insurance regulator to be insolvent and unable to fulfill its commitments, the state steps in to rehabilitate or liquidate the insurer's assets. The guaranty fund then uses the assets to pay the claims on the company, typically up to a limit of $300,000 for property/casualty insurance[14] and $300,000 for life insurance death benefits and $100,000 for life insurance cash value and annuities.[15] In most states, the existing insurers in the state are assessed to make up the difference should the company's assets be unable to fund the guaranty fund payments. This after the fact assessment stands in contrast, for example, to the FDIC, which is funded by assessments on banks prior to a bank failure and which holds those assessments in a segregated fund until needed. Insurers who are assessed by guaranty funds generally are permitted to write off the assessments on future state taxes, which indirectly provide state support for the guaranty funds.

The Gramm-Leach-Bliley Act

The 1999 Gramm-Leach-Bliley Act (GLBA)[16] significantly overhauled the general financial regulatory system in the United States. Support for GLBA came largely as a result of changes in market forces, frequently referred to as "convergence." Convergence in the financial services context refers to the breakdown of distinctions separating different types of financial products and services, as well as the providers of once separate products. Drivers of such convergence are generally considered to be market forces such as globalization, new technology, e-commerce, deregulation, market liberalization, increased competition, tighter profit margins, and the growing number of sophisticated consumers.

GLBA repealed federal laws that seemed inconsistent with the way that financial services products were actually being delivered, and removed many barriers that kept banks or securities firms from competing with insurance companies. The result was the creation of a new competitive paradigm in which insurance companies found themselves in direct competition with brokerages, mutual funds, and commercial banks. GLBA did not, however, change the basic regulatory structure for insurance or other financial products. Instead, it reaffirmed the McCarran-Ferguson Act, recognizing state insurance regulators as the "functional" regulators of insurance products and those who sell them.

Some insurance companies believe that in the post-GLBA environment, state regulation places them at a competitive disadvantage in the marketplace. They maintain that their non-insurer competitors in certain lines of products have federally based systems of regulation that are more efficient, while insurers remain subject to perceived inefficiencies of state insurance regulation, such as the regulation of rates and forms as well as other delays in getting their products to market. For example, life insurers with products aimed at retirement and asset accumulation must now compete with similar bank products. Banks can roll out such new products nationwide in a matter of weeks, while some insurers maintain that it can take as long as two years to obtain all

[13] For more information, see CRS Report RL32175, *Insurance Guaranty Funds*, by Baird Webel.

[14] National Conference of Insurance Guaranty Funds, "Facts and Statistics," available at http://www.ncigf.org/media-facts.

[15] National Organization of Life & Health Insurance Guaranty Associations, "Frequently Asked Questions," available at http://www.nolhga.com/policyholderinfo/main.cfm/location/questions.

[16] P.L. 106-102, 113 Stat. 1338.

the necessary state approvals for a similar national insurance product launch. In the aftermath of GLBA, the largely united industry resistance to federal intervention in insurance changed. Many industry participants, particularly life insurers, larger property/casualty insurers, and larger insurance brokers, began supporting broad regulatory change for insurance in the form of an optional federal charter for insurance patterned after the dual chartering system for banks.[17]

GLBA also addressed the issue of modernizing state laws dealing with the licensing of insurance agents and brokers and made provision for a federally backed licensing association, the National Association of Registered Agents and Brokers (NARAB), which would have come into existence three years after the date of enactment if at least 29 states failed to enact the necessary legislation for state uniformity or reciprocity. Following GLBA, the requisite number of states enacted this legislation, and thus the NARAB provisions never came into effect. The issue of insurance producer licensing reciprocity or uniformity continued, as some saw and continue to see problems in the actions taken by the individual states. Not every state has passed legislation implementing reciprocity, and some have argued that it has not always been implemented as smoothly as desired even in those states that did.[18]

Insurance after the Gramm-Leach-Bliley Act

Congress passed the Gramm-Leach-Bliley Act to enhance competition among financial services providers. Though many observers expected banks, securities firms, and insurers to converge as institutions after it passed, this has not occurred as expected. In fact, the major merger between a large bank, Citibank, and a large insurer, Travelers, which actually spurred the passage of GLBA, has effectively been undone. The corporation that resulted from the merger, Citigroup, has divested itself of almost all of its insurance subsidiaries. Although large bank-insurer mergers did not occur as expected, significant convergence continued. Instead of merging across sectoral lines, banks began distributing—but not "manufacturing"—insurance, and insurers began creating products that closely resembled financing. Consolidation also continued within each sector, as banks merged with banks and insurers with insurers. In addition, although Congress instituted "functional regulation" in GLBA, regulation since has still tended to track institutional lines.[19]

From the 107th through the 110th Congresses, congressional interest in insurance regulatory issues continued, particularly in the House of Representatives. The House Financial Services Committee held more than a dozen hearings at both the subcommittee and full committee levels on insurance matters over this time. A number of broad proposals for some form of federal chartering or other federal intervention in insurance regulation were put forward in both houses of Congress and by the Administration, but none were marked up or reported by the various committees of

[17] Banking charters are available from both the individual states and the federal government. For more information on optional federal charter legislation, see CRS Report RL34286, *Insurance Regulation: Federal Charter Legislation*, by Baird Webel.

[18] See, for example, the April 16, 2008, testimony by Tom Minkler on behalf of the Independent Insurance Agents and Brokers made before the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises at http://www.house.gov/apps/list/hearing/financialsvcs_dem/minkler041608.pdf.

[19] See CRS Report RS21827, *Insurance Regulation After the Gramm-Leach-Bliley Act*, by Carolyn Cobb. Functional regulation would entail, for example, insurance regulators overseeing insurance products being offered by banks, while banking regulators would oversee banking products offered by insurers. Institutional regulation tends to focus more on the charter of the institution so, for example, banking regulators oversee all the activities of a bank even if the bank is offering insurance products.

jurisdiction.[20] In the same time frame, a number of narrower bills affecting different facets of insurance regulation and regulatory requirements were also introduced in Congress, including bills addressing surplus lines[21] and reinsurance, insurance producer licensing, and expansion of the Liability Risk Retention Act beyond liability insurance.

Insurance and the Financial Crisis

As the 110th Congress approached its close, the financial crisis that began in 2007 reached panic proportions with the conservatorship of Fannie Mae and Freddie Mac, the failure of Lehman Brothers, and the government rescue of American International Group (AIG) in September 2008. This crisis overlaid a range of new issues and arguments to the previously existing debate on insurance regulatory reforms. The financial crisis grew largely from sectors of the financial industry that had previously been perceived as presenting little systemic risk, including insurers. Many see the crisis as resulting from failures or holes in the financial regulatory structure, particularly a lack of oversight for the system as a whole and a lack of coordinated oversight for the largest actors in the system. This increased the urgency in calls for overall regulatory changes, such as the implementation of increased systemic risk regulation and federal oversight of insurance, particularly larger insurance firms. The generally good performance of insurers in the crisis, however, also provided additional arguments for those seeking to retain the state-based insurance system.

Although insurers in general are considered to have weathered the financial crisis reasonably well, the insurance industry saw two notable failures, one general and one specific. The first failure was spread across the financial guarantee or monoline bond insurers. Before the crisis, there were about a dozen bond insurers in total, with four large companies dominating the business. This type of insurance originated in the 1970s to cover municipal bonds but the insurers expanded their businesses since the 1990s to include significant amounts of mortgage-backed securities. In late 2007 and early 2008, strains began to appear due to this exposure to mortgage-backed securities. Ultimately some bond insurers failed and others saw their previously triple-A ratings cut significantly. These downgrades rippled throughout the municipal bond markets, causing unexpected difficulties for both individual investors and municipalities who might have thought they were relatively insulated from problems stemming from rising mortgage defaults.

The second failure in the insurance industry was that of a specific company, American International Group.[22] AIG had been a global giant of the industry, but it essentially failed in mid-September 2008. To prevent bankruptcy in September and October 2008, AIG sought more than $100 billion in assistance from the Federal Reserve, which received both interest payments and warrants for 79.9% of the equity in the company in return. Multiple restructurings of the assistance have followed, including nearly $70 billion through the U.S. Treasury's Troubled Asset Relief Program (TARP). The rescue ultimately resulted in the U.S. government owning 92% of

[20] Broad proposals from the 107th to 110th Congresses included the National Insurance Act of 2007 (S. 40 and H.R. 3200, 110th Congress); the National Insurance Act of 2006 (S. 2509 and H.R. 6225, 109th Congress); the Insurance Consumer Protection Act of 2003 (S. 1373, 108th Congress); and the Insurance Industry Modernization and Consumer Protection Act (H.R. 3766, 107th Congress), and the 2008 *Blueprint for a Modernized Financial Regulatory Structure* released by the U.S. Treasury and available at http://www.treasury.gov/press-center/press-releases/Documents/Blueprint.pdf.

[21] Surplus lines insurance is insurance sold by insurance companies not licensed in the particular state where it is sold. For background on this insurance, see CRS Report RS22506, *Surplus Lines Insurance: Background and Current Legislation*, by Baird Webel.

[22] See CRS Report R40438, *Federal Government Assistance for American International Group (AIG)*, by Baird Webel.

the company. All the Federal Reserve assistance to AIG has been repaid and the U.S. Treasury has sold all but 15.9% if its equity stake in the company.

The near collapse of the bond insurers and AIG could be construed as regulatory failures. One of the responsibilities of an insurance regulator is to make sure the insurer remains solvent and is able to pay its claims. Because the states are the primary insurance regulators, some may go further and argue that these cases specifically demonstrate the need for increased federal involvement in insurance. The case of AIG, however, is a complicated one. Although AIG was primarily made up of state-chartered insurance subsidiaries, at the holding company level it was a federally regulated thrift holding company with oversight by the Office of Thrift Supervision (OTS). The immediate losses that caused AIG's failure came from both derivatives operations overseen by OTS and from securities lending operations that originated with securities from state-chartered insurance companies. OTS claimed it had sufficient regulatory authority and competence to oversee a complicated holding company such as AIG. Others, particularly the Federal Reserve, disputed this claim and argued that a single body is needed to oversee systemic risk and large financial holding companies. Ultimately the Federal Reserve's view prevailed and the OTS was absorbed into the Office of the Comptroller of the Currency with its holding company oversight authority transferred to the Federal Reserve by the Dodd-Frank Act.

The 111th Congress responded to the financial crisis with the Dodd-Frank Wall Street Reform and Consumer Protection Act,[23] which enacted broad financial regulatory reform. Although the Dodd-Frank Act had a number of provisions that directly and indirectly addressed insurance, it left the states as the primary functional regulators of insurance. The Dodd-Frank Act provisions that most directly addressed insurance and are of ongoing concern were (1) creation of a Federal Insurance Office (FIO); (2) systemic-risk provisions, such as the creation of a Financial Stability Oversight Council (FSOC) with the authority to oversee systemically important insurers; and (3) previously introduced provisions harmonizing the tax and regulatory treatment of surplus lines insurance and reinsurance (the Nonadmitted and Reinsurance Reform Act).[24] Dodd-Frank provisions regarding holding company oversight may also affect a number of companies who are primarily insurers, but who also have banking or thrift subsidiaries and are thus now overseen by the Federal Reserve.

Issues in the 112th Congress

Insurance issues before the 112th Congress include

- Oversight and implementation of the Dodd-Frank Act;
- Legislation that would narrowly reform the current regulatory system, such as H.R. 1112 that would harmonize the state regulation of insurance producer licensing and H.R. 2126 that would extend the Liability Risk Retention Act; and
- Response to international developments, such as the changes to the European Union's regulatory scheme known as Solvency II.

Recent insurance legislation that has not been introduced in the 112th Congress includes legislation to create a federal charter and regulatory apparatus for insurance (H.R. 1880 in the

[23] P.L. 111-203, 124 Stat. 1376. See CRS Report R41350, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Issues and Summary*, coordinated by Baird Webel.

[24] For more information on the specific insurance provisions in the Dodd-Frank Act, see CRS Report R41372, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Insurance Provisions*, by Baird Webel.

111th Congress) and to remove or limit the McCarran-Ferguson Act's antitrust exclusion for the general business of insurance (H.R. 1583 in the 111th Congress).

The House Committee on Financial Services' Subcommittee on Insurance, Housing, and Community Opportunity has held hearings entitled "Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs" on July 28, 2011;[25] "Insurance Oversight and Legislative Proposals" on November 16, 2011;[26] "U.S. Insurance Sector: International Competitiveness and Jobs" on May 17, 2012;[27] and "The Impact of Dodd-Frank's Insurance Regulations on Consumers, Job Creators, and the Economy" on July 24, 2012.[28] The full House Committee on Financial Services marked up the Insurance Data Protection Act (H.R. 3559) on December 8, 2011. In the Senate, the Committee on Banking, Housing, and Urban Affairs held a July 26, 2011, full committee hearing on the nomination of S. Roy Woodall Jr. to be the insurance expert on the FSOC[29] and a September 14, 2011, subcommittee hearing on "Emerging Issues in Insurance Regulation."[30]

Implementation of the Dodd-Frank Act

Federal Insurance Office

Title V, Subtitle A of the Dodd-Frank Act creates an FIO headed by a director inside of the Department of the Treasury. FIO is to monitor all aspects of the insurance industry and coordinate and develop policy relating to international agreements. It has the authority to preempt state laws and regulations when these conflict with international agreements. This preemption authority is somewhat limited. It can only apply when the state measure (1) results in less favorable treatment of a non-U.S. insurer compared with a U.S. insurer, and (2) is inconsistent with a written international agreement regarding prudential measures. Such an agreement must achieve a level of consumer protection that is "substantially equivalent"[31] to the level afforded under state law. FIO preemption authority does not extend to state measures governing rates, premiums, underwriting, or sales practices, nor does it apply to state coverage requirements or state antitrust laws. FIO preemption decisions are also subject to *de novo* judicial review under the Administrative Procedure Act.[32] The monitoring function of FIO includes information gathering from both public and private sources. This is backed by subpoena power if the director issues a written finding that the information being sought is necessary and that the office has coordinated with other state or federal regulators that may have the information. In the 112th Congress, H.R. 3559, which would limit this subpoena power, has been marked up by the House Financial Services Committee (see below for more complete information).

[25] See http://financialservices.house.gov/Calendar/EventSingle.aspx?EventID=252895.

[26] See http://financialservices.house.gov/Calendar/EventSingle.aspx?EventID=268154.

[27] See http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=295049.

[28] See http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=303378.

[29] See http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=20f65c19-a4ee-4f18-a21a-0a86c3f1dbda.

[30] See http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_id=3c45e919-0503-4ed0-bc3c-0fb3b2b50ca7.

[31] 31 U.S.C. §313(r)(2) as added by P.L. 111-203 §502; the law renumbers the current 31 U.S.C. §313 as 31 U.S.C. §312.

[32] 5 U.S.C. §551 *et seq.*

Since the passage of the Dodd-Frank Act, the FIO has hired staff and appointed a director, Michael McRaith, a former Illinois insurance commissioner. The office has been active in international discussions with Director McRaith recently elected to head a technical committee of the International Association of Insurance Supervisors (IAIS). The process of starting FIO, however, has taken longer than some hoped. Mr. McRaith did not take up the position of director until June 2011, nearly a year after the enactment of Dodd-Frank. In addition, reports to Congress on the modernization of the insurance regulatory system and on reinsurance called for in Dodd-Frank have yet to be released.

Systemic Risk Provisions

The Dodd-Frank Act provides for systemic-risk provisions that potentially affect the insurance industry primarily through enhanced Federal Reserve oversight and higher prudential standards for all banks with greater than $50 billion in assets as well as any other firms deemed systemically important financial institutions (SIFIs) and through financial resolution authority to be undertaken by the FDIC. Designation of SIFIs is to be done by the FSOC. The FSOC is "charged with identifying risks to the financial stability of the United States; promoting market discipline; and responding to emerging risks to the stability of the United States' financial system."[33] It includes a presidential appointee who is to be familiar with insurance issues, a state insurance commissioner, and the FIO director, with the latter two being non-voting members.[34]

The higher prudential standards may be set by the Federal Reserve based on various risk-related factors. The statutory standards include risk-based capital requirements that account for off-balance-sheet activities, leverage limits, liquidity requirements, risk management requirements, and exposure limits of 25% of a company's capital per counterparty. Other prudential standards may be applied at the Federal Reserve's discretion. The firms are required to submit resolution plans ("living wills") and credit exposure reports. Regulated subsidiaries continue to be regulated by their primary functional regulator, although the functional regulator may be overridden if the Federal Reserve believes the firm is not adhering to regulatory standards or poses a threat to financial stability. The Federal Reserve must conduct annual stress tests on systemically significant firms and, in consultation with the FSOC and the FDIC, issue regulations establishing remediation measures to be imposed at an early stage of a firm's "financial decline" in an effort to prevent insolvency and its potential impact on the financial system. The Federal Reserve has put forth a proposed rule detailing the higher prudential standards, but the rule has not been finalized.[35] It is unclear whether a second rule specifically for non-bank institutions will be released or if one rule will be applied to all SIFIs.[36]

A financial company could be subject to the act's special resolution regime based on a finding that its failure would cause systemic disruption. Any insurance subsidiaries of such a financial company, however, would not be subject to this regime. Instead, the resolution of insurance companies would continue to be conducted in accordance with the applicable state insurance resolution system, although the FDIC would have "backup authority" to resolve insurers if the

[33] See the FSOC website at http://www.treasury.gov/initiatives/fsoc/Pages/home.aspx.

[34] For more information on the FSOC, see CRS Report R42083, *Financial Stability Oversight Council: A Framework to Mitigate Systemic Risk*, by Edward V. Murphy.

[35] Information about the proposed rule can be found at http://federalreserve.gov/newsevents/press/bcreg/20111220a.htm.

[36] This information adapted from CRS Report R41384, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Systemic Risk and the Federal Reserve*, by Marc Labonte.

state system has not acted within 60 days of a finding. With regard to funding for the resolution of systemically important financial firms, there is no pre-funded resolution mechanism under the act. Instead, the FDIC is to impose assessments on financial companies with more than $50 billion in assets, as well as other financial firms that are overseen by the Federal Reserve, to fund the resolution of a systemically important firm in the event the assets of the failed firm are insufficient to do so. The FDIC is to impose such assessments on a risk-adjusted basis. When imposing such assessments on an insurance company, the FDIC is to take into account the insurers' contributions to the state insurance resolution regimes. The FDIC has begun issuing rules regarding the new resolution regime, but has not specifically addressed insurers.[37] In the 112th Congress, H.R. 6423 has been introduced which would remove insurers from this resolution authority (see below for more complete information).

FSOC held its first meeting on October 1, 2010, and has begun issuing studies and rules. Of particular significance to insurers was a final rule issued April 3, 2012, detailing the criteria the FSOC would use to judge nonbank financial companies systemically important and require additional oversight by the Federal Reserve.[38] In general, most insurers have argued that they do not pose a systemic risk due to particular facets of insurance operations, such as the longer-term nature and lower liquidity of risks faced by insurers and the high capital required by state insurance regulators.[39] Although FSOC does not publicly release the companies that it is examining for designation as systemically important, a number of insurers have indicated that they are under such consideration. To date, however, no firms have been deemed systemically important by the FSOC.

Federal Reserve Holding Company Oversight

The Dodd-Frank Act consolidated oversight of thrift holding companies and bank holding companies under the Federal Reserve. The act also strengthened the capital standards applied to these holding companies, particularly through Section 171, which was originally offered as an amendment by Senator Susan Collins. Separately from Dodd-Frank, the Federal Reserve is also implementing higher capital standards for banks as put forth in the Basel III agreement. Although the provisions in Dodd-Frank and Basel III do not affect the business of insurance *per se*, according to information provided by the NAIC, 27 bank or thrift holding companies now overseen by the Federal Reserve are largely engaged in the business of insurance.[40] Some of these companies are very small, but some, including AIG, Nationwide, and State Farm, are among the largest insurers in the United States. In general, the banking or thrift subsidiary operations of these 27 holding companies are relatively small compared with the insurance operations, with the

[37] Information on the FDIC's role in implementing Dodd-Frank can be found at http://www.fdic.gov/regulations/reform/.

[38] Text of the final rule can be found on the FSOC website at http://www.treasury.gov/initiatives/fsoc/Documents/Nonbank%20Designations%20-%20Final%20Rule%20and%20Guidance.pdf.

[39] See, for example, comments submitted on the FSOC rule by the American Council of Life Insurers and the Property and Casualty Insurers Coalition, available at http://www.regulations.gov/#!documentDetail;D=FSOC-2011-0001-0024 and http://www.regulations.gov/#!documentDetail;D=FSOC-2011-0001-0023.

[40] These companies are Mutual of Omaha, Alfa Mutual, Donegal Mutual, USAA, Ohio Farmers, First American Financial Corp., MetLife, New Jersey Manufacturers, Thrivent Financial, Polish National Alliance, Auto Club Insurance Assoc., Nationwide Mutual, Principal Financial, State Farm, Ameriprise, UnitedHealth, Ameritas Mutual Holding Co., AIG, TIAA-CREF, Modern Woodmen of America, W.R. Berkley Corp., Shelter Mutual, First American Corp., MassMutual, Wisconsin Physicians Service, Illinois Agricultural Association, and Minnesota Mutual. Two companies, Northwestern Mutual and Prudential Financial, recently received permission from the Fed to deregister as savings and loan holding companies and thus not be subject to Fed holding company oversight.

combined banking/thrift assets totaling approximately $124.3 billion compared with combined assets for the insurance operations of $23 trillion. One notable exception to this, however, is USAA, whose thrift assets are nearly as large as its insurance assets.[41]

In addition to consolidated capital standards, the application of Section 619 of Dodd-Frank, commonly known as the "Volcker Rule" could impact insurers with banking subsidiaries. This section includes restrictions on proprietary trading that potentially could affect the investment strategies of insurers. The language, however, includes an exemption for trading done "by a regulated insurance company directly engaged in the business of insurance for the general account of the company by any affiliate of such regulated insurance company, provided that such activities by any affiliate are solely for the general account of the regulated insurance company."[42] The transactions must also comply with applicable law, regulation, or guidance. There must be no determination by the regulators that a relevant law, regulation, or guidance is insufficient to protect the safety and soundness of the banking entity or the financial stability of the United States.[43] The FSOC has released a study on the Volcker Rule required by Dodd-Frank, which includes a discussion of the insurance company exemption with a particular recommendation that "the appropriate Agencies should carefully monitor fund flows between banking entities and insurance companies, to guard against 'gaming' the Volcker Rule."[44]

Federal Reserve Chairman Ben Bernanke indicated in July 18, 2012, testimony before the House Financial Services Committee that "we recognize insurance companies have both a different composition of assets and a different set of liabilities, and appropriate regulation needs to take that into account."[45] Insurers, however, have expressed concern that capital rules proposed by the Federal Reserve do not take account of particular characteristics of the industry and describe the rules as "bank-centric."[46] Some insurers are taking steps, such as selling their banking subsidiaries, to remove themselves from Federal Reserve oversight and the resulting application of the various rules put forth in Dodd-Frank and Basel III. MetLife is the largest firm to undertake this, although such steps would not necessarily prevent the FSOC from designating an insurer as systemically important and thus subject to Federal Reserve oversight from this perspective.

Surplus Lines and Reinsurance

Title V, Subtitle B of the Dodd-Frank Act addresses a relatively narrow set of insurance regulatory issues pre-dating the financial crisis. In the area of nonadmitted (or "surplus lines") insurance, the act harmonizes, and in some cases reduces, regulation and taxation of this insurance by vesting the "home state" of the insured with the sole authority to regulate and collect the taxes on a surplus lines transaction. Those taxes that would be collected may be distributed according to a future interstate compact or agreement, but absent such an agreement their distribution would be within the authority of the home state. It also preempts any state laws on

[41] According to the NAIC, USAA has $55.5 billion in banking assets vs. $56.0 billion in insurance assets.

[42] P.L. 111-203 §619(d)(1)(F).

[43] This description is from CRS Report R41298, *The "Volcker Rule": Proposals to Limit "Speculative" Proprietary Trading by Banks*, by David H. Carpenter and M. Maureen Murphy; please see this report for additional information on the proposal.

[44] Financial Stability Oversight Council, *Study & Recommendations On Prohibitions On Proprietary Trading & Certain Relationships With Hedge Funds & Private Equity Funds*, January 2011, pp. 71-75.

[45] See Chairman Bernanke's response to questioning from Rep. Judy Biggert in the archived hearing webcast at http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=302778, beginning at approximately 1:54.

[46] Comments can be found at http://www.federalreserve.gov/apps/foia/ViewComments.aspx?doc_id=R-1442&doc_ver=1, see, for example, page 25 of the State Farm comment letter at http://www.federalreserve.gov/SECRS/2012/October/20121025/R-1442/R-1442_101912_109851_308150202515_1.pdf.

surplus lines eligibility that conflict with the National Association of Insurance Commissioners model law unless the states include alternative uniform requirements as part of an agreement on taxes and implement "streamlined" federal standards allowing a commercial purchaser to access surplus lines insurance. For reinsurance transactions, it vests the home state of the insurer purchasing the reinsurance with the authority over the transaction while vesting the home state of the reinsurer with the sole authority to regulate the solvency of the reinsurer.

NAIC and NCOIL both developed interstate agreements that would supersede the federal provisions on tax distribution. The two models that were developed, however, differed significantly as to the extent of authority that would be ceded by the states to the new body overseeing the agreement. NCOIL's Surplus Lines Insurance Multistate Compliance Compact (SLIMPACT) is a broader agreement that would address surplus lines regulatory issues and taxes, whereas the NAIC's Nonadmitted Insurance Multi-State Agreement (NIMA) is more narrowly focused on tax allocation. Each approach has been ratified by some states, but most states have ratified neither. This lack of uniformity was addressed in congressional hearings, and representatives of the NAIC and NCOIL particularly pledged to address the issue, possibly through some sort of blending of the two approaches, before the House Financial Services Committee.[47] It is unclear, however, how much progress has been achieved toward uniformity since this hearing.

Legislation in the 112th Congress

The National Association of Registered Agents and Brokers Reform Act of 2011 (H.R. 1112)

H.R. 1112 was introduced by Representative Randy Neugebauer along with 47 cosponsors on March 16, 2011. A similar bill was introduced in the 110th and 111th Congresses and passed the House in each Congress, but was not acted upon by the Senate. H.R. 1112 has been referred to the House Committee on Financial Services.

H.R. 1112 would establish a National Association of Registered Agents and Brokers (NARAB). NARAB would be a private, nonprofit corporation, whose members, once licensed as an insurance producer in a single state, would be able to operate in any other state subject only to payment of the licensing fee in that state. The NARAB member would still be subject to each state's consumer protection and market conduct regulation, but individual state laws that treated out-of-state insurance producers differently from in-state producers would be preempted. NARAB would be overseen by a board made up of five appointees from the insurance industry and four from the state insurance commissioners. The appointments would be made by the President, and the President could dissolve the board as a whole or suspend the effectiveness of any action taken by NARAB.

NARAB dates back to the Gramm-Leach-Bliley Act of 1999,[48] and the current legislation is often referred to as "NARAB 2." GLBA included the provisional creation of a NARAB to streamline state insurance producer licensing for agents and brokers. The GLBA NARAB provisions, however, were not to go into effect if a majority of the states enacted uniformity in their insurance

[47] See U.S. Congress, House Committee on Financial Services, Subcommittee on Insurance, Housing and Community Opportunity, *Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs*, 112th Cong., 1st sess., July 28, 2011, particularly the statements by Mr. Clay Jackson and Ms. Letha E. Heaton, available at http://financialservices.house.gov/Calendar/EventSingle.aspx?EventID=252895.

[48] Specifically, P.L. 106-102, Title III, Subtitle C. See the previous discussion under "The Gramm-Leach-Bliley Act."

producer licensing laws and reciprocity for nonresident producer licensing laws. The states met these GLBA requirements. However, according to the NAIC, California, Florida, and Washington, who together represent approximately 20% of the nation's population, have not implemented uniformity and reciprocity laws.

The Risk Retention Modernization Act of 2011 (H.R. 2126)

H.R. 2126 was introduced by Representative John Campbell along with Representative Peter Welch on June 3, 2011. It has been referred to the House Committee on Financial Services.

This bill would expand the Liability Risk Retention Act (LRRA)[49] federal preemption of state insurance laws, allowing risk retention groups (RRGs) to cover commercial property risks and risk purchasing groups (RPGs) to purchase coverage for commercial property risks. The bill would also change the enforcement mechanism for federal preemptions in the LRRA and add additional federal corporate governance, disclosure, and fiduciary duty requirements for RRGs under the act.

Under existing law, the federal preemptions in the LRRA are enforced through court action. If a risk retention group believes a state is attempting to regulate in a manner counter to the LRRA, it can bring suit in a federal court. H.R. 2126 would create a process under which the director of the Federal Insurance Office could issue determinations as to whether a state's regulation of a RRG or RPG is preempted by the act. In addition, the director is to study and issue reports to Congress on the states' regulation of RRGs and RPGs and the compliance with the LRRA.

The corporate governance standards to be issued by the director of the FIO would include requirements that a majority of directors on an RRG's board be independent, any audit committee be made up of independent directors, written governance standards be in place, and contracts with service providers be limited to less than five years and be approved by the state insurance commissioner. Additional specific amendments to the LRRA would expand the consumer disclosure required in the act and impose a fiduciary duty on the board of directors of a risk retention group.

The Insurance Data Protection Act (H.R. 3559)

H.R. 3559 was introduced by Representative Steve Stivers on December 5, 2011. It was marked up by the Subcommittee on Insurance, Housing and Community Opportunity of the House Committee on Financial Services on December 8, 2011, and approved for consideration by the full committee on a vote of seven to five. No schedule for full committee consideration has been announced. H.R. 3559 was also referred to the House Committee on Agriculture.

This bill would remove the Federal Insurance Office's authority to issue subpoenas in its information gathering efforts and exclude insurance companies from the Office of Financial Research's subpoena authority. It would also extend existing FIO confidentiality requirements that apply to insurance information gathered by FIO to the sharing of such data by FIO or the gathering of such data by federal financial regulators.

[49] 15 U.S.C. §3901 *et seq*. For more information, see CRS Report RL32176, *The Liability Risk Retention Act: Background, Issues, and Current Legislation*, by Baird Webel.

The Insurance Consumer Protection and Solvency Act (H.R. 6423)

H.R. 6423 was introduced by Representative Bill Posey along with Representative Judy Biggert on September 14, 2012. It has been referred to the House Committee on Financial Services. Although no hearings directly on H.R. 6423 have been held, the bill in draft form was discussed in a subcommittee hearing in November 2011.[50]

H.R. 6423 would amend Dodd-Frank so that insurance companies would essentially no longer be subject to the resolution regime created in this law. It would strike the FDIC's backup authority to resolve insurance subsidiaries in the case of inaction by state authorities and exclude insurance companies from the FDIC's assessment authority to cover the cost of FDIC resolution.

International Issues

Although financial services is not an industry that produces a tangible good to be shipped across borders, the trade in such services makes up a large segment of international trade. The United States has generally experienced a surplus in trade in financial services, other than insurance, but in insurance services the United States has consistently run a deficit with the rest of the world.[51] Consolidations in the insurance industry are creating larger international entities with growing market shares, particularly in the reinsurance market. Some have speculated that the growing "internationalization" of the financial services industry means governments may find it difficult to reform their regulation in isolation. The need for a single voice at the federal level to represent U.S. insurance interests on the international stage is a frequently heard argument for increased federal involvement in insurance regulation. The FIO is specifically tasked with developing federal policy in international insurance matters.

The European Union and Solvency II

The European Union (EU), the United States' biggest trading partner in insurance services, is implementing a comprehensive program to transform the EU into a single market for financial services. Part of this is an updated solvency regime for insurers—known as Solvency II—attempting to more closely match the capital required by regulators to the risks undertaken by insurers. It is

> an ambitious proposal that will completely overhaul the way we ensure the financial soundness of our insurers. We are setting a world-leading standard that requires insurers to focus on managing all the risks they face and enables them to operate much more efficiently.[52]

[50] See U.S. Congress, House Committee on Financial Services, Subcommittee on Insurance, Housing and Community Opportunity, *Insurance Oversight and Legislative Proposals*, 112th Cong., 1st sess., November 16, 2011, http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=268154.

[51] In 2011, U.S. exports of non-insurance financial services were $74.1 billion in 2011 versus imports of $16.2 billion compared with insurance exports that totaled $15.5 billion versus imports of $56.6 billion. See the Bureau of Economic Analysis website at http://www.bea.gov/iTable/iTable.cfm?ReqID=6&step=1, Table 3a.

[52] Charlie McCreevy, European Union Internal Market and Services Commissioner, quoted in "'Solvency II': EU to take global lead in insurance regulation" available at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1060&format=HTML&aged=0&language=EN&guiLanguage=en. The general EU website on Solvency 2 is http://ec.europa.eu/internal_market/insurance/solvency/index_en.htm.

The European Parliament first passed Solvency II legislation in 2009. Implementation was originally expected in 2012, with the date then pushed to 2014, but delays in further European Parliament approval have put the 2014 implementation in doubt.

As part of the Solvency II project, the EU created a new European Insurance and Occupational Pensions Authority (EIOPA) with the ability to develop regulations and rules that are binding at a European level, in contrast to the advisory nature of its predecessor. A more efficient regulatory system in the EU could improve the competitive standing of EU insurers compared with U.S. insurers. Concerns have also been expressed that new EU system might effectively discriminate against U.S. insurers, particularly if state supervision of U.S. insurers is judged insufficiently equivalent to allow the same access to all EU countries that EU insurers will enjoy. EIOPA has published reports on equivalence for Switzerland, Bermuda, and Japan and recommended equivalence for these countries, but has not done so for the United States. There have been suggestions in the past that an EU regulatory change might serve as "a useful tool in international trade negotiations as it could help improve access for European reinsurers to foreign markets," such as the United States.[53] The EU has also cited the overall complexity of the regulatory system in the United States as a barrier to overseas companies operating in the United States.[54]

Reinsurance Collateral

Just as U.S. insurers see access to the EU as a significant issue under Solvency II, access to the U.S. market for insurance is also a significant issue for EU insurers. Of particular concern have been the state regulatory requirements that reinsurance issued by non-U.S. or "alien"[55] reinsurers must be backed by 100% collateral deposited in the United States. Non-U.S. reinsurers have asked state regulators to reduce this requirement to as low as 50% for insurers who meet particular criteria, pointing out, among other arguments, that U.S. reinsurers do not have any collateral requirements in many foreign countries and that the current regulations do not recognize when an alien reinsurer cedes some of the risk back to a U.S. reinsurer. In the past, the NAIC has declined to recommend a collateral reduction, citing fears of unpaid claims from non-U.S. reinsurers and an inability to collect judgments in courts overseas. In 2009, the NAIC put forth draft federal legislation to create a board with the power to enforce national standards for reinsurance collateral, including the reduction of collateral for highly rated reinsurers.[56] In 2010, an NAIC Task Force approved recommendations to reduce required collateral based on the financial strength of the reinsurer involved. This proposal was adopted as a model law and regulation by the NAIC in November 2011. To take effect, however, these changes must be made to state law and regulation by the individual state legislatures and insurance regulators. According to the NAIC, 11 states, collectively representing 40% of the primary insurance premiums in the United States, have adopted revised statutes or regulations with respect to reinsurance collateral reduction.[57] Of the 11 states, however, only Florida and New York have approved any reinsurers for collateral reduction.

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[53] European Commission, "Commission Proposes a Directive to Create a Real EU-Wide Market for Reinsurance," *Internal Market: Financial Services: Insurance: Press Release,* at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/04/513&format=PDF&aged=1&language=EN&guiLanguage=en.

[54] See, for example, p. 54 of the European Commission's *US Barriers to Trade and Investment Report for 2007*, at http://trade.ec.europa.eu/doclib/docs/2008/april/tradoc_138559.pdf.pdf.

[55] In the United States, the term "foreign" insurer generally denotes an insurer that is chartered in a different state; those insurers from a different country are called "alien" insurers.

[56] The NAIC proposal can be found on their website at http://www.naic.org/committees_e_reinsurance.htm.

[57] These states include California, Connecticut, Delaware, Florida, Georgia, Indiana, Louisiana, New Jersey, New York, Pennsylvania, and Virginia.

State Regulatory Modernization Efforts

Following the passage of GLBA, state insurance regulators working through the NAIC embarked on a regulatory modernization program. These efforts were in response to both the mounting criticisms of state insurance regulation and the recognition of the growing convergence of financial services and financial services products. In early 2000, NAIC members signed a *Statement of Intent: The Future of Insurance Regulation*, in which they pledged "to modernize insurance regulation to meet the realities of the new financial services marketplace." New NAIC working groups were formed addressing issues such as state privacy protections, reciprocity of state producer licensing laws, promotion of "speed to market" of new insurance products, development of state-based uniform standards for policy form filings, and other proposed improvements to state rate and form filing requirements. Highlights of the post-GLBA NAIC efforts include the following:

- Certification of 47 states (as of September 2008) as reciprocal jurisdictions for producer licensing laws,[58] thus exceeding the GLBA requirements to prevent the establishment of NARAB. The NAIC has also gone past the GLBA requirements[59] and adopted heightened standards for reciprocity with 37 states possibly being considered as meeting these standards.
- Continued growth of the System for Electronic Rate and Form Filing (SERFF), intended to be a single, one-stop point of entry for insurers to file changes to rates and forms. More than 558,000 filings were made through the system in 2011, up from about 3,700 in 2001, although this is a small drop from 2010. Forty-nine states participate in the system, which claims an average of a 47-day turnaround for life/health filings and a 28-day turnaround for property/casualty filings over the past 12 month.[60]
- State approvals of the Interstate Insurance Product Regulation Compact. This compact is intended to provide increased regulatory uniformity and a single point of product filing for four insurance lines—life, annuities, disability income, and long-term care. It came into effect in May 2006.[61] Currently, 41 states[62] have joined the compact. These 41 states will represent approximately two-thirds of the insurance premium volume. Three additional states[63] have current legislation pending to endorse the compact.

The NAIC maintains that states are better positioned than the federal government to serve the interests of U.S. insurance consumers, emphasizing that state regulators are better suited to ensure that the personal interests of consumers are not lost in the arena of commercial competition. In 2010, according to the NAIC, the total budget for the state insurance departments was nearly $1.3 billion. The states handled more than 304,000 official consumer complaints and 2.1 million consumer inquiries regarding their policies and their treatment by insurance companies and

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[58] See http://www.naic.org/urtt_utlr.htm.

[59] See the previous discussion under "The Gramm-Leach-Bliley Act."

[60] See http://www.serff.org/about.htm.

[61] See http://www.insurancecompact.org.

[62] AK, AL, CO, GA, HI, IA, ID, IL, IN, KS, KY, LA, MA, MD, ME, MI, MN, MO, MS, NC, NE, NH, NJ, NM, NV, OH, OK, OR, PA, RI, SC, TN, TX, UT, VA, VT, WA, WI, WV, and WY. Puerto Rico is also a member.

[63] California, Florida, and New York.

agents. In 2010, the states collectively employed more than 11,600 employees to handle these complaints and perform the other functions of the state insurance departments.

In the aftermath of the financial crisis, the NAIC indicated support for federal efforts to address systemic risk "while preserving State-based insurance regulation,"[64] according to 2009 testimony before the Senate. More recent NAIC testimony before the House detailed several changes in response to the experience in the financial crisis independent of federal efforts. These changes include strengthening the oversight of insurance holding companies through revisions to the NAIC model laws on holding company oversight and increasing oversight on insurers' securities lending, two areas that the experience with AIG during the financial crisis showed to be particularly problematic. The NAIC is also making changes to reduce insurance regulators' reliance on credit rating agencies. In addition, the NAIC launched a "Solvency Modernization Initiative" to examine "international developments regarding insurance supervision, banking supervision, and international accounting standards in order to consider their potential use in U.S. insurance."[65]

[64] Prepared Testimony of The Honorable Michael T. McRaith in U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Perspectives on Modernizing Insurance Regulation*, 111th Cong., 1st sess., March 17, 2009, available at http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=9d32d178-0b51-415d-989d-8bd87d6477e0.

[65] Prepared Testimony of Iowa Insurance Commissioner Susan E. Voss in U.S. Congress, House Committee on Financial Services, Subcommittee on Insurance, Housing and Community Opportunity, *Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs*, 112th Cong., 1st sess., July 28, 2011, available at http://financialservices.house.gov/UploadedFiles/072811voss.pdf. See also http://naic.org/index_smi.htm.

Appendix. Past Proposals for Regulatory Reform

2008 Treasury Blueprint

In March 2008, then-Secretary of the Treasury Henry Paulson released a *Blueprint for a Modernized Financial Regulatory Structure*. Although the financial crisis had begun at that time, the Treasury blueprint was not primarily a response to the crisis, but instead an attempt to create "a more flexible, efficient and effective regulatory framework."[66] A wide-ranging document, the blueprint foresaw a completely revamped regulatory structure for financial services.

The 2008 Treasury model proposed a prudential regulator to oversee the solvency of individual companies, a business conduct regulator to oversee consumer protection, and a market stability regulator to oversee risks to the entire system. As an intermediate step, it made two specific recommendations on insurance regulation. First, it called for the creation of a federal insurance regulator to oversee an optional federal charter for insurers as well as federal licensing for agents and brokers. Second, recognizing that the debate over an optional federal charter was ongoing in Congress, it recommended the creation of an "Office of Insurance Oversight" in the Department of the Treasury as an interim step. This office would be charged with two primary functions: (1) dealing with international regulatory issues, including the power to preempt inconsistent state laws; and (2) collecting information on the insurance industry and advising the Secretary of the Treasury on insurance matters.

President Obama's Financial Regulatory Reform Plan

In June 2009, the Treasury Department under Secretary Timothy Geithner released a whitepaper entitled *Financial Regulatory Reform: A New Foundation*, outlining President Obama's plan to reform financial regulation in the United States.[67] The plan did not foresee as complete an overhaul as did the 2008 blueprint, but it would have substantially changed the financial regulatory system. Specific changes called for included explicitly introducing systemic risk oversight by the Federal Reserve, combining the Office of Comptroller of the Currency and the Office of Thrift Supervision into a single banking regulator, and creating a new Consumer Financial Protection Agency.

Although the June report stated that the Administration was open to additional changes in the insurance regulatory system, the specific regulatory changes called for in the released legislative language were focused on areas other than insurance. Most insurance products, for example, were excluded from the jurisdiction of the new federal consumer protection agency. In general, the states were to continue to have a preeminent role in insurance regulation. Insurance regulation, however, would have been specifically affected through two other aspects of the President's plan: the regulation of large financial companies presenting systemic risk and the creation of a new Office of National Insurance within the Treasury.

Systemic risk regulation as proposed in the legislation would have been the primary responsibility of the Federal Reserve in conjunction with a new Financial Services Oversight Council made up of the heads of most of the federal financial regulators. The powers to regulate for systemic risk enumerated in the draft legislation extended to all companies in the United States engaged in financial activities. Although the draft legislation did not specifically name insurers as subject to

[66] U.S. Treasury, "Treasury Releases Blueprint for Stronger Regulatory Structure," press release, March 31, 2008, available at http://www.ustreas.gov/press/releases/hp896.htm.

[67] See the U.S. Treasury website at http://ustreas.gov/initiatives/regulatoryreform/.

federal systemic risk regulation, it would seem to have included them under federal jurisdiction. Companies judged to be a possible threat to global or U.S. financial stability could be designated Tier 1 Financial Holding Companies and made subject to stringent solvency standards and additional examinations. Such companies would also be subject to enhanced resolution authority rather than standard bankruptcy provisions. Although the draft language did make reference in some places to state functional regulatory agencies, it was left open exactly how the Federal Reserve as regulator of the financial holding company would interact with the state regulators of the individual insurance subsidiaries. Whether federal regulatory deferral to state regulators would have continued under the proposed legislation seemed an unresolved question.

Although systemic risk regulation would likely apply to a relatively small number of insurers, the called-for creation of an Office of National Insurance could have had a broader impact. Unlike the similarly named office in other legislation, such as H.R. 1880 in the 111th Congress, President Obama's Office of National Insurance would not have overseen a federal insurance charter or have had direct regulatory power over insurers. Rather, this office was to operate as a broad overseer and voice for insurance at the federal level, including collecting information on insurance issues, setting federal policy on insurance, representing the United States in international insurance matters, and preempting some state laws where these laws are inconsistent with international agreements.

Unenacted Legislation in the 111th Congress

Several pieces of legislation addressing insurance regulation or regulatory requirements were introduced and not enacted in the 111th Congress, including both broad and narrow proposals. This legislation included the following:

The Insurance Industry Competition Act of 2009 (H.R. 1583)

Representative Peter DeFazio and five cosponsors introduced H.R. 1583 in the House on March 18, 2009. H.R. 1583 was referred to the House Judiciary Committee, House Financial Services Committee and House Energy and Commerce Committee. No hearings or markups were held on the bill.

H.R. 1583 would have abolished the current exemption from federal antitrust laws for the "business of insurance" that dates to the McCarran-Ferguson Act of 1945 and removed a prohibition on investigations of insurance companies by the Federal Trade Commission. It would not have changed the sections of the McCarran-Ferguson Act that give preeminence to state insurance regulators.

The National Insurance Consumer Protection Act (H.R. 1880)

Representatives Melissa Bean and Edward Royce introduced H.R. 1880 in the House on April 2, 2009. The bill was referred to the House Financial Services Committee, House Judiciary Committee, and House Energy and Commerce Committee. No further action was taken on the bill.

This bill would have created a federal charter for the insurance industry, including insurers, insurance agencies, and independent insurance producers. The federal insurance regulatory apparatus was to be an independent entity under the Department of the Treasury, and the federal law would have preempted most state insurance laws for nationally regulated entities. Thus, nationally licensed insurers, agencies, and producers would have been able to operate in the entire

United States without fulfilling the requirements of each of the 50 states' individual insurance laws.

H.R. 1880 also addressed the issue of systemic risk by designating another entity to serve as a systemic risk regulator for insurance. The systemic risk regulator was to have the power to compel systemically significant insurers to be chartered by the federal insurance regulator. Thus, although the bill shared some similarities with past optional federal charter legislation, and would have allowed some insurers to choose whether to obtain a federal charter, it was not purely an optional federal charter bill.

The National Association of Registered Agents and Brokers Reform Act of 2009 (H.R. 2554)

This bill was introduced by Representative David Scott along with 34 cosponsors on May 21, 2009. A similar bill was introduced in the 110th Congress, where it passed the House but was not acted upon by the Senate. H.R. 2554 passed the House on March 3, 2011, and was subsequently referred to the Senate Committee on Banking, Housing, and Urban Affairs, but was not acted upon by the Senate.

H.R. 2554 would have established a National Association of Registered Agents and Brokers (NARAB). NARAB was to be a private, nonprofit corporation, whose members, once licensed as an insurance producer in a single state, would be able to operate in any other state subject only to payment of the licensing fee in that state. The NARAB member was still to be subject to each state's consumer protection and market conduct regulation, but individual state laws that treated out-of-state insurance producers differently than in-state producers would be preempted. NARAB would have been overseen by a board made up of five appointees from the insurance industry and four from the state insurance commissioners. The appointments were to be made by the President, and the President would have had the power to dissolve the board as a whole or suspend the effectiveness of any action taken by NARAB.

The Risk Retention Modernization Act of 2010 (H.R. 4802)

H.R. 4802 was introduced by Representative Dennis Moore (along with Representatives John Campbell and Suzanne Kosmas) on March 10, 2010. It was referred to the House Committee on Financial Services but was not acted upon further.

This bill would have expanded the federal preemption of state insurance laws, allowing risk retention groups to cover commercial property risks and risk purchasing groups to purchase coverage for commercial property risks. The bill would also have changed the enforcement mechanism for federal preemptions in the LRRA, and added additional federal corporate governance, disclosure, and fiduciary duty requirements for risk retention groups under the act.

Under existing law, the federal preemptions in the LRRA are enforced through court action. If a risk retention group believes a state is attempting to regulate in a manner counter to the LRRA, it can bring suit in a federal court. H.R. 4802 would have created a process under which the Secretary of the Treasury could issue determinations as to whether a state's regulation of a RRG or RPG is preempted by the act. In addition, the Secretary of the Treasury and the Comptroller General would have studied and issued reports to Congress on the states' regulation of RRGs and RPGs and the compliance with the LRRA. The corporate governance standards to have been put into place by the bill would have included requirements that a majority of directors on an RRG's board be independent; any audit committee be made up of independent directors; written governance standards be in place; and contracts with service providers be limited to less than five years and be approved by the state insurance commissioner. Specific amendments to the LRRA would have expanded the consumer disclosure required in the act and imposed a specific fiduciary duty on the board of directors of a risk retention group.

The Federal License for Reinsurers Act of 2010 (H.R. 6529)

Representative Dennis Moore introduced H.R. 6529 on December 16, 2010. It was referred to the House Committee on Financial Services but no hearings or markups were held on the bill. H.R. 6529 would have created a federal license for reinsurers. The licensing and regulatory authority would rest with the FIO, which was created under the Dodd-Frank Act, which would have the authority to determine that state laws were inconsistent with federal law and thus preempted.

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